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# Employer Responses to UI Experience Rating: Evidence from Canadian and American Establishments

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## Purpose

This brief summarizes the preliminary results of a study of differences in Canadian and American employer responses to unemployment insurance. The primary concern of the research involves the relationship between UI financing, on the one hand, and layoffs and employer-sponsored training, on the other. The principal issue under investigation centres on the impacts of experience rating on these two aspects of employer behaviour. Specifically, the objective of the evaluation is to test two hypotheses: (i) *ceteris paribus*, an establishment is more likely to adjust to a fall in labour demand through layoffs, the less its UI premiums are accurately regulated by experience rating; and (ii) *ceteris paribus*, an establishment is less likely to invest in training, the less its UI premiums are accurately related to experience rating. A secondary issue addressed by the research concerns the relationship between the availability of UI short-term compensation (or worksharing) and layoffs.

## Background

Policy-makers and economists are familiar with the extensive literature on the effects of unemployment insurance on the behaviour of workers. The general conclusion of this analysis is that the availability of UI benefits does extend the duration of joblessness, though

the degree to which it does is the subject of some controversy. In comparison, far less attention has been paid to how UI influences the behaviour of firms. There are theoretical reasons, however, to expect that features of an unemployment insurance system, especially its financing, would have impacts on employer decisions, most particularly regarding layoffs.

Indeed, in recent years a series of American studies has offered empirical support for the hypothesis that the way UI is financed on the employer side does affect layoff behaviour. In the U.S., the contributions made by firms are partially "experience rated" in that they are affected to some extent by their layoff history. The degree of experience rating – i.e., the marginal tax increase of an additional layoff – varies by state and American researchers have used this variation to measure the impact of experience rating on layoffs. The major conclusion of these studies is that "incomplete" experience rating creates an incentive to employers to engage in layoffs, specifically temporary and seasonal layoffs. The research further indicates that more closely tying employer UI taxes to past layoffs, while reducing future layoffs, could constrain employment levels by discouraging hiring in anticipation of higher layoff costs down the road.

In Canada, employer premiums are unaffected by layoff history. In light of the U.S. research, this raises the question of whether the absence



of experience rating leads to more use of layoffs by Canadian firms compared to their American counterparts. Moreover, this issue has a logical extension to employer-based training: if the expected effect of "zero" experience rating on layoffs indeed exists, then this would be anticipated to have a negative impact on training. The reason for this is that high layoff rates will be associated with low tenure and it has been well established that the incidence of training is positively correlated with employee tenure.

## Methodology and Data.

Designing a research methodology to examine the impacts of the Canadian UI system on employer behaviour is inherently problematic since there is no variation in financing arrangements or in other program features of interest. To get the necessary variation, the study included firms in Canada and the U.S. By restricting the analysis to two manufacturing industries (machinery and fabricated metal products) and four "border" jurisdictions (Ontario, Pennsylvania, Minnesota, and Wisconsin), the research strategy involved observing the layoff and training patterns of employers producing common products within the same market but operating under different UI regimes.

In each industry, establishments were surveyed in Ontario (with no experience rating), a state with a "liberal" UI regime (low, but some, experience rating), and a state with a "tight" UI system (a high degree of experience rating). In machinery, the jurisdictions sampled were Ontario, Wisconsin (liberal), and Minnesota (tight) while, in metals, Ontario, New York (liberal), and Pennsylvania (tight) were included. The analysis is based on a final sample of 300 establishments in five "sector-jurisdictions" (New York was dropped because of poor response). In each case, establishment data were gathered on turnover (layoffs and hiring) and training, and a range of other variables that could be expected to influence these. The operating hypotheses were that,

*ceteris paribus*, Ontario firms would report more layoffs (specifically temporary layoffs), and less training than their counterparts in the liberal-UI states and, especially, the tight-UI ones.

## Results

The descriptive evidence on 1993 layoffs generally conformed with expectations. In both sectors, Ontario establishments reported the highest layoff rates, both in terms of temporary and total layoffs. Clearly, the observed differences across jurisdictions could be due to numerous factors, including differences in the various UI systems. To consider the impact of the range of possible explanatory factors, establishment turnover models were specified and tested. These models incorporated a number of establishment variables including sales growth, employment, recent technological change, innovation in human resource practices, collective bargaining status, the female and youth shares of the workforce, an industry dummy variable, as well as a jurisdiction dummy variable, the local unemployment rate, and a measure of the degree of experience rating in the jurisdiction. This last variable – the key variable in the analysis – was proxied by the UI "marginal tax cost" (MTC), calculated in earlier published research (with a value of 0 for Ontario respondents).

The estimated models explained between 25 and 30 per cent of the variation in establishment layoff and hiring rates. According to the analysis, the observed differences in these rates between jurisdictions were primarily due to the higher unemployment rates in Ontario than in the American localities. The MTC variable coefficient was statistically insignificant in each of the estimations, offering no support for the hypothesis that experience rating (at least differences in average rates across jurisdictions) acts as a significant deterrent to layoffs.



This result is consistent with qualitative evidence gathered from survey respondents on the role of experience rating in their layoff decisions. U.S. establishments, even those in "tight" UI jurisdictions, attributed relatively little importance to experience rating in deciding whether or not to lay off workers. In each of the states included, fewer than five per cent of the respondents felt that experience rating had a significant effect; over one-half believed it had little or no impact. In contrast, Ontario employers, faced with the theoretical notion of experience rating, evaluated it as a potentially much more important factor.

The survey also collected data on respondents' use of various layoff avoidance measures, including hiring freezes, wage freezes/cuts, reduced hours, retraining, and early retirement. The expectation was that use of these measures would increase with the degree of experience rating. However, the econometric results do not support this hypothesis: in most cases, there were no significant differences across jurisdictions and where differences were significant, they indicated that Ontario respondents were more likely to use the layoff avoidance strategies.

An analysis of the relationship between short-time compensation (STC), or UI Worksharing, and layoff rates was undertaken using the Ontario subsample. (UI-sponsored STC does not exist in any of the U.S. jurisdictions included in the survey.) The results indicate a positive and significant relationship between use of STC and the establishment temporary layoff rate. While this might seem to be a perverse result given the objective of STC to reduce temporary layoffs, it almost certainly reflects the fact that employers instituting a worksharing plan are likely to be operating in a high-layoff environment. The results do suggest, however, that worksharing may have had a muted effect on layoffs (where high rates would have been even higher).

The final stage of the research considered the hypothesis that UI parameter differences would affect the extent of workplace training reported in the various jurisdictions. Since this was

based on prior expectations regarding the effect of UI on layoffs, which were not supported by the analysis, it is not surprising that no evidence was found to link the UI regime with training activity.

## Conclusions

The analysis does not support the hypotheses regarding the potential impacts of UI experience rating on firm behaviour. That is, greater degrees of experience rating in a UI system do not, *ceteris paribus*, deter employers from using layoffs to adjust to declines in labour demand, or encourage them to engage in greater training. This does mean that the unemployment insurance system has no influence on decisions employers make regarding layoffs or training. However, this study finds no evidence that differences in the degree of experience rating affect their behaviour in these areas.

The conclusions, specifically on the layoff impacts of UI, run counter to some other studies. There are a number of candidate reasons to explain this. Some of these relate to potential limitations stemming from the exploratory nature of this study. For example, the analysis is restricted to two sectors which may not be representative of the broader economy. The measure of experience rating is not firm-specific but is based on a jurisdiction average for a group of industries. There may be data quality problems, something any researcher using employer survey data should acknowledge.

It is also possible, however, that the aspects of UI examined here really do not have significant impacts on employer behaviour. Relatively few studies have looked at this relationship and, among those that have, only a very small number have used firm-level data covering a wide range of control variables. Perhaps experience rating, especially in its incomplete form, is not a significant enough force to substantially influence employers in their layoff decisions. As well, firms in jurisdictions with experience rating may become adept at

minimizing its impact by concentrating layoffs on exempt employees and by defining layoffs as quits where possible.

To conclude, the research, while exploratory, draws attention to a set of issues that has largely been ignored in the literature. More exhaustive establishment-level data collection and analysis in a range of industries is important for understanding how UI affects employer behaviour.

## Biographical Notes

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Copies of the full technical report (when finalised) and further copies of this summary are available from:

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